COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Request of Fitchburg Gas and Electric Light Company d/b/a Unitil for Approval Of a Large Customer Basic/Default Service Procurement Pilot Program	))))	D.T.E. 06-74

COMMENTS OF RETAIL ENERGY SUPPLY ASSOCIATION
ON UNITIL'S REQUEST FOR BASIC SERVICE PILOT

INTRODUCTION

The Retail Energy Supply Association ("RESA") is a nonprofit organization and trade association that represents the interests of its members in regulatory proceedings in the New England, New York, Mid-Atlantic and Great Lakes regions. RESA's members include providers of competitive supply products to electricity consumers in the five New England states – including Massachusetts – that have restructured their electric markets.[1]

RESA is pleased to file these Comments with respect to the August 31, 2006 request (the "Request") for Department of Telecommunications and Energy ("Department") approval filed by Fitchburg Gas and Electric Light Company d/b/a Unitil ("Unitil" or the "Company"). As discussed in the Department's Notice of Filing and Request for Comments dated September 13, 2006 ("Department Notice"), the Request seeks to initiate a Pilot program for procurement of basic service (referred to as "default

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1 RESA member companies include Consolidated Edison Solutions, Inc., Direct Energy Services, LLC, Hess Corporation, Reliant Energy Solutions, Sempra Energy Solutions, Strategic Energy, LLC, SUEZ Energy Resources NA, Inc. and U.S. Energy Savings Corp. The opinions expressed in this filing may not represent the views of all members of RESA.

service" or "DS" in the Request) for Unitil's largest commercial and industrial ("C&I") customers. Under the program, Unitil would solicit a new variable monthly price basic service in addition to the fixed monthly priced basic service solicited under current Department practices.[2] The Company would then review bid results under each solicitation and determine whether to accept the fixed monthly price bid or the variable monthly priced bid.[3]

RESA commends Unitil for its innovative proposal and urges the Department to grant leave for Unitil to implement it as soon as practicable. Unitil's proposed addition of a solicitation for a variable monthly price basic service – consisting of the load-weighted monthly average of the real-time locational marginal price ("LMP") for the West/Central Massachusetts load zone plus a fixed monthly adder to cover all non-energy related costs – would better align basic service pricing for the largest C&I customers in Unitil's service area with underlying real-time market prices, in accordance with longstanding Department precedent. Other notable specifics of the Pilot program include that the variable product would be optional, customers would be shifted to a uniform calendar month billing cycle, and Unitil would undertake customer education efforts. The Request should improve responsiveness to basic service solicitations, improve the accuracy of electricity price signals for those Massachusetts businesses that remain on basic service, and support the robust and customer-benefiting growth of retail competition in the Commonwealth.

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2 Department Notice at 1.

3 Id.

OVERVIEW OF UNITIL PILOT PROGRAM

The Company has been procuring power for its large C&I class (G-3) based on monthly fixed price service secured through solicitations every three months.[4] The vast majority of Unitil's G-3 customers are currently served by competitive retail supply alternatives (i.e., 25 of 34 large customers, totalling 90% of large customer sales).[5] Unitil nevertheless states that it has experienced substantial short-term migration from competitive supply to basic service at times in the past when wholesale market prices have risen above existing basic service prices during the three-month term of a basic service contract, with a reverse flow happening after wholesale prices decline relative to the fixed basic service contract prices.[6] Since wholesale suppliers are required to maintain or procure sufficient supply to meet the service needs of all unexpected load often at current market rates substantially above the price specified in the basic service contract, Unitil asserts that the "dynamic" between changing market prices and the three-month fixed prices set by contract "has become inconsistent with the volume risk tolerance of many suppliers," leading to "a reduced wholesale supplier interest in offering fixed monthly price supply for the large customer [basic service] over time."[7]

Unitil proposes to respond to this phenomenon by creating a basic service product that is priced in better alignment with wholesale power markets. Instead of relying exclusively on the results of fixed price procurements every three months, Unitil would

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4 Request, p. 2; see also Department Order (2000) Docket No. 02-40-C, p. 22 (requiring three month procurement cycles for medium and large commercial customers).

5 Request at p. 2.

6 Id. at 2-3 & Attachment 1 (basic service v. competitive generation from January 2002 to July 2006).

7 Id. at 3.

solicit bids for a monthly variable price basic service option that would consist of the load-weighted monthly average for the real-time LMP in the West/Central Massachusetts load zone plus a fixed monthly adder to cover all non-energy costs such as capacity, ancillary services and ISO administrative charges.[8] The winning bidder would be the one with the lowest fixed monthly adder for the three-month procurement period (assuming it met Unitil's non-price evaluation criteria).[9] The final retail rates would be calculated after the month of service but prior to customer billing, since the weighted average LMP for that month would not be known until after month end.[10]

As part of the Pilot, Unitil will change the customer billing cycles for the G-3 class to coincide with a calendar month (rather than on unique cycles for each customer that could start at any time during the month) to make cycles consistent and avoid complicated mixed-month offerings that could impose costs on suppliers that would be priced into any retail offerings to Unitil customers.[11] In connection with the Pilot, Unitil will commit to an extensive customer education program and placement of public and proprietary information on its website.[12]

Unitil sees numerous advantages and little or no disadvantages to its proposed Pilot variable price offering. Among other favorable attributes, the variable pricing offer would: (1) likely increase supplier participation in the procurement process, since

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8 Id. at 3-4.

9 Id.

10 Id.

11 Id. at 5.

12 Id. at 4-5, 6. Unitil included with its request draft revised versions of a request for proposals and draft Power Supply Agreement. Id. at Attachments 6 and 7.

suppliers would be able to better hedge the transaction; (2) prevent customers from using basic service as a back-up supply option, since the customer would not know the applicable monthly LMP price until after the end of each month; and (3) rely on variable prices, which have become a viable supply option and, over time, can produce lower prices for customers than fixed prices.[13] In addition, by offering the opportunity to participate in both fixed price and variable price solicitations, Unitil believes it will receive the best offers from wholesale suppliers irrespective of their preferences for fixed or variable processes, and can pick the best one for its customers.[14]

COMMENTS ON PILOT PROGRAM

A. The Pilot Program Should Improve Wholesale Participation in Basic Service Solicitations, Bring Benefits to Customers, and Improve Retail Competition.

RESA supports the Unitil Pilot outlined in the Request. The Pilot will bring real benefits to customers through enhanced wholesale participation in basic service solicitations and continued improvement in the competitiveness of the retail markets in the Commonwealth. It seeks to address a root cause of periodic volatility experienced in basic service procurements – that fixed price procurements over periods as short as several months can lead to substantial migrations onto or off of basic service when real-time market prices deviate materially from fixed procurement prices. By permitting wholesale suppliers to shorten the procurement cycle to one month (down from three months) and linking pricing to real-time market prices, the Pilot should reduce multiple customer migrations, reduce the level of risk premiums included in responsive bids as

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13 Id. at 4.

14 Id. at 4. Unitil will provide the Department with an analysis supporting its conclusion regarding which bidder to select. Id. at 4-5 and Attachment 4 (confidential evaluation criteria).

compared to an RFP seeking full requirements service, and lead to prices more reflective of the wholesale market for customers electing to remain on basic service.

Importantly, the Pilot seeks to achieve these beneficial ends in a manner that supports retail competition in the large and medium C&I classes in the Commonwealth. Unitil recognizes that a substantial majority of its G-3 customers are on competitive supply and that such customer-beneficial retail competition should be supported rather than hindered.[15] Rather than relying on switching restrictions that limit customer choice,[16] the Pilot properly seeks to minimize the use of basic service as a vehicle for short-term arbitrage opportunities directly by tying the bulk of the basic service price to the prevailing hourly market price for energy. With more timely and accurate price signals, customers can better evaluate the broad array of risk-managed products and services offered by retail energy suppliers – a process that is a necessary and defining feature of a robust retail market. The Department has recognized the potential benefits of a change to a one-month procurement term. Specifically, in the Order in Docket No. 02-40-B, the Department wrote:

> A persuasive, though not yet convincing, case can be made for the proposition that a procurement term of one month would (1) provide efficient price signals to customers because the resulting prices would track wholesale market price on a monthly basis; (2) provide customers with the appropriate level of price certainty; and (3) provide appropriate protection from spot market price volatility. Under this approach, distribution companies would procure their default service supply one month in advance on an on-going basis . . . . Customers, in turn, would

[15] See Request at 2, 5. Indeed, ISO New England recently discussed that pricing generation service on a dynamic basis "would encourage competitive retail suppliers to provide [new] products in the competitive retail market." Comments of ISO New England, Inc. on Wholesale and Retail Electricity Competition, Nov. 18, 2005, p. 33, Federal Energy Regulatory Commission, Docket No. AD05-17-000.

[16] Compare Order of the Department (July 12, 2006), Docket No. 05-84 (approving NSTAR proposal for restrictions on customers returning from basic service to the same competitive supplier over a six month period). In the Docket No. 05-84, RESA proposed a move to monthly pricing for basic service to large C&I customers as a pro-competitive alternative to NSTAR's proposed switching restrictions.

> know the level of default service prices for only the next month . . . . [C]ustomers that seek greater price certainty could appropriately turn to the competitive market for these protections.[17]

Although the Department subsequently determined that a one-month procurement cycle could not be adopted in 2002, it expressed a willingness to explore it in the future. [18] The suggested Pilot program creates the perfect opportunity to test monthly pricing based on average hourly-priced service. Moreover, in the three years that have passed since the Department issued its order in DTE 02-40-B and C, the use of the backward-looking, load-weighted average of hourly LMPs as the basis for a monthly price has alleviated many – if not all – of the concerns expressed regarding the administrative difficulties of conducting a monthly procurement.

Finally, the proposal will only benefit – not harm – Unitil customers. If suppliers do not provide attractive responses to the variable monthly pricing solicitations, Unitil can continue to rely on the results of the traditional fixed price procurements.[19] Alternatively, if the variable product proves to be the better deal but a particular C&I customer values the stability of fixed-price service, Unitil recognizes that such customers can obtain access to fixed-priced offerings from the competitive market. In either event, by attracting more wholesale suppliers to the Unitil RFP, the Pilot furthers the interests of Unitil's C&I customers and the public interest and should be approved by the Department.

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17 D.T.E. 02-40-B (2003), p. 39.

18 D.T.E. 02-40-C (2003), p. 22.

19 Request at 5-6.

B. Monthly Variable Pricing is Consistent With the Objectives of Basic Service for Large Customers and Societal Benefits.

In addition to the above-cited advantages for customers, wholesale suppliers and retail competition, the Request furthers the Department's longstanding objectives for provision of basic service to large customers. The Department has made clear that basic service ideally should serve as a short-term last resort service for large customers and that rates should be set in a manner that provide incentives for customers to rely on the competitive offerings rather than a government-mandated basic service offering.[20] On a small, manageable basis, the Pilot would advance both of those objectives. Customers will see timelier price signals (one month versus three months) and will have more information on which to draw in deciding which supply options meet their particular needs. That is a major reason the Department has long been on record that shorter procurement periods – including monthly periods – are desirable and should be implemented if feasible.[21]

The Pilot fully comports with national trends implementing shorter procurement periods that better match market pricing for large C&I customers, as many other states are investigating and adopting shorter basic service procurement periods, including implementation of hourly real-time pricing. For example, the New York State Public Service Commission, citing the numerous benefits of real-time pricing discussed in these Comments, recently ordered the implementation of mandatory hourly-priced default

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20 Department Order (2000) Docket No. 02-40-B, p. 7.

21 Department Order (2000) Docket No. 02-40-B, p. 39; Department Order (2000), Docket No. 02-40-C, p. 22. See also Department Order (2005) Docket No. 05-84, at pp. 16-17 (noting advantages of hourly real-time pricing for reducing migration risk but that such a long term solution needs to be studied prior to implementation).

service for customers with peak demands as low as 500 kW.[22] The Maryland Public Service Commission has established mandatory hourly-priced default service for customers with peak demands of 600 kW and higher,[23] and these customers have not been exposed to the same price spikes that were experienced by the Baltimore Gas and Electric Company's residential customers in 2005. The Pennsylvania Public Utility Commission has implemented hourly-priced default service in the Duquesne Power and Light service territory for customers with peak demands of 300 kW and higher,[24] which has resulted in a customer migration rate in excess of 90%. Mandatory hourly default service pricing programs in these three states have yielded – and continue to yield – significant benefits to large C&I customers who are sufficiently sophisticated to read price signals and shop for their desired products. This body of experience with very short procurement periods supports Unitil's more modest proposal to investigate a shift from quarterly to monthly pricing of basic service in which the energy component is priced based on the load-weighted average of hourly prices.

The Pilot also would help foster the societal benefits that occur when basic service pricing more closely matches market pricing. More accurate price signals should

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22 See Order of the New York State Public Utility Commission ("NYSPC") Denying Petitions for Rehearing and Adopting Mandatory Hourly Pricing Requirements (April 24, 2006), pp. 14-15, 20, Case No. 03-E-0641 ("Order"). Specifically, the NYSPC ordered implementation of hourly default service for the following service territories: Niagara Mohawk Power Corporation – 500 kW and higher; New York State Electric and Gas Corporation – 1,000 kW and higher; Rochester Gas and Electric Corporation – 1,000 kW and higher; and Consolidated Edison Company of New York, Inc. – 1,500 kW and higher. See Appendix A to Order.

23 See Order No. 78400 of the Maryland Public Service Commission Approving Hourly-Priced Default Service for Class III Standard Offer Customers (April 29, 2003), pp. 8-9, Case No. 8908.

24 See Order of the Pennsylvania Public Utility Commission Denying Petition for Reconsideration and Implementing Mandatory Hourly Pricing for Large Customers in the Duquesne Power and Light Service Territory (Oct. 5, 2004), pp. 35-37, Docket No. P-00032071.

help encourage participation in demand response programs during peak usage months and should help improve the functioning of wholesale electricity markets.[25]

CONCLUSION

RESA appreciates the opportunity to participate and provide written comments in this proceeding. As discussed above, RESA strongly supports the proposed monthly variable pricing service Pilot as an innovative, pro-consumer and pro-competition mechanism for improving basic service procurement in the Unitil service territory. RESA highly recommends that the Department approve Unitil's plan on or before the October 6, 2006 deadline stated in the Company's Request.

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[25] A recent study of how customers respond to real-time pricing conducted by the Center for Energy, Economic & Environmental Policy at Rutgers University found that "the performance of competitive wholesale markets is improved by providing customers with an incentive to respond to high wholesale prices" and that real-time pricing "could serve to improve market efficiency, mitigate market power, dampen wholesale volatility, and bolster system reliability." Center for Energy, Economic & Environmental Policy, Rutgers University, Assessment of Customers Reponses to Real Time Pricing – Task 1: Literature (June 30, 2005), p. 18, available at http://policy.rutgers.edu/ceeep/images/Assessment%20of%20Customer%20Response%20to%20Real%20Time%20Pricing%20Report%20June%2030%2020053.pdf